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ESSAY

INCOTERMS: FACILITATING TRADE
IN THE ASIAN PACIFIC

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1. INTRODUCTION

This Essay outlines a recommendation for the Asian Pacific Parliamentarians Forum ("APPF") to endorse the International Commercial Terms ("INCOTERMS") promulgated by the International Chamber of Commerce ("ICC"). INCOTERMS are a set of standardized definitions for commonly used shipping terms such as "Free on Board" ("F.O.B."). Section 2 explains the use of INCOTERMS in an international sales agreement and how usage of INCOTERMS benefits trade. Section 3 presents the ultimate objective of persuading APPF to recognize the merits of INCOTERMS and to lobby the Asian Pacific Economic Forum

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("APEC") to take action on this issue. In Section 4, the proposal recommends that, as a means of facilitating trade in the Asia Pacific, APPF endorse the adoption of INCOTERMS by member nations as the legal authority for the use of shipping terms in international sales agreements. It describes a procedure by which an APPF working group would issue a report to APEC urging APEC to include this issue in its agenda. The proposal provides model legislation in Appendix A, illustrating the legislative action required to adopt INCOTERMS, and ends in Appendix B with a sample resolution, which APPF might use in endorsing trade term standardization among its members.

2. INCOTERMS AND INTERNATIONAL COMMERCE

The purpose of 'INCOTERMS' is to provide a set of international rules for the interpretation of the chief terms used in foreign trade contracts, for the optional use of businessmen who prefer the certainty of uniform international rules to the uncertainties of the varied interpretations of the same terms in different countries.¹

To meet the needs of international business, the International Chamber of Commerce ("ICC")² devised legal definitions of trade terms such as "Free On Board" ("F.O.B.") and "Carriage, Insurance, and Freight" ("C.I.F."). Such terms are commonly used in domestic and international sales agreements to divide the responsibility for various tasks relating to the transportation of sold goods.³

In 1920, the ICC conducted a study on the interpretation of

¹ INTERNATIONAL CHAMBER OF COMMERCE, INCOTERMS: INTERNATIONAL RULES FOR THE INTERPRETATION OF TRADE TERMS 1 (1980).

² The ICC is a world business organization dedicated to facilitating global trade. For example, banks can choose to have ICC's Uniform Credits and Practice rules ("UCP 500") govern the obligations arising from the issuance of a letter of credit to finance an international sale. One commentator estimates that UCP 500 governs ninety-five percent of all international letters of credit. See Ross P. Buckley, *The 1993 Revision of the Uniform Customs and Practice For Documentary Credits*, 28 GEO. WASH. J. INT'L L. & ECON. 265, 266 (1995).

³ The current version of Incoterms is INTERNATIONAL CHAMBER OF COMMERCE, INCOTERMS 1990 (1990) [hereinafter INCOTERMS 1990]. This Essay deals only with the international sale of goods; it does not treat contracts for services.

the most commonly used trade terms. The study found that different countries interpreted terms such as F.O.B. and C.I.F. in different ways. As a result, the outcome of litigation involving an international sale of goods might vary between jurisdictions applying different meanings to common commercial terms such as F.O.B. and C.I.F. The possibility of inconsistent judicial outcomes created additional obstacles and risks for parties engaged in — and wishing to engage in — international transactions. To solve problems attendant to the interpretation of trade terms across national borders, the ICC promulgated its own set of standardized trade terms, International Commercial Terms or INCOTERMS.⁴ INCOTERMS offer stability and predictability to agreements for the international sale of goods by providing the parties with the option of incorporating standardized trade terms in their contracts.

Parties to international sales contracts use INCOTERMS as shorthand for allocating the collective rights and obligations arising from transportation of the goods sold under their agreement. Each INCOTERMS term spells out a different breakdown of the various responsibilities arising from transportation of the goods, such as who provides a carrier to ship the goods; who packs and loads the goods; who carries the risk of damage to the goods during transport;⁵ who provides export documents; who provides import documents; and who pays customs duties and incidental freight charges. INCOTERMS 1990 is the authoritative publication containing definitions of the most commonly used trade terms.⁶ For example, under current international law, the buyer and seller have expeditiously defined their contractual obligations in regard to the above issues if their agreement

⁴ CHARLES DEL BUSTO, ICC GUIDE TO DOCUMENTARY CREDIT OPERATIONS 12 (1995).

⁵ Of course, the carrier may be liable for damage to the goods occurring during transportation, but the seller and buyer must determine to whom the carrier is liable. See, e.g., ROBERT H. FOLSOM ET AL., INTERNATIONAL BUSINESS TRANSACTIONS 93-98 (3d ed. 1995). Note that the contractual obligations between the shipper (the person sending the goods) and the carrier (the person carrying the goods) are governed by a separate body of law such as the Hague Rules, Hague-Visby Rules, or the Hamburg rules. The United States adopted the Hague-Visby Rules which is known in the United States as COGSA. See 46 U.S.C. app. §§ 1300-15 (1997); see also W. TETLEY, MARINE CARGO CLAIMS 1 (3d ed. 1988).

⁶ See INCOTERMS 1990, *supra* note 3, at 6.

contains the following provision: "This contract is F.O.B. Wilmington, DE, U.S.A. (INCOTERMS 1990)."

By including the acronym F.O.B. and incorporating INCOTERMS 1990 as the interpretive authority for the meaning of F.O.B., the parties have agreed to the sharing of responsibilities for transporting the goods contained in the official 1990 ICC definition of F.O.B. The definition, found in INCOTERMS 1990, stipulates the following:

The seller will, at the seller's expense, supply goods in conformity with the contract packaged according to normal trade custom and secure a bill of lading from the carrier appointed to ship the goods from Wilmington, Delaware. The seller shall also provide good faith assistance to the buyer in obtaining all additional documents including export and import certificates. The seller must also deliver the goods on board the vessel named by the buyer and notify the buyer of the goods' delivery. The buyer, in turn, has agreed to assume the expense and burden of contracting with a carrier and providing the seller with a place and date to deliver the goods to the carrier. The buyer pays the cost of obtaining supplementary documentation including documents provided by the seller. Most importantly, the risk of damage to the goods shifts from seller to buyer exactly at the point where the goods pass over the railing of the carrier's ship.

As the example illustrates, the mere inclusion of the letters F.O.B. cleanly and distinctly apportions responsibilities between buyer and seller over various matters, which they must otherwise remember to include in the contract themselves.⁷ However, the parties must include the parenthetical phrase "(INCOTERMS 1990)" to benefit from the INCOTERMS definition and to avoid uncertainty as to what meaning a court would give to the term F.O.B.

To illustrate further, suppose that a Canadian buyer and Thai

⁷ See *id.* at 5; see also Daniel E. Murray, *Risk of Loss of Goods in Transit: A Comparison of the 1990 Incoterms with Terms from Other Voices*, 23 U. MIAMI INTER-AM L. REV. 93, 103-108 (1991).

seller signed a contract with the phrase, "F.O.B. Bangkok, Thailand" without including "(INCOTERMS 1990)." Today, the failure to include "(INCOTERMS 1990)" would expose the parties to an uncertain resolution of a legal dispute. Uncertainty arises if a court must construe the meaning of the term F.O.B. The court first must determine whether the contract was executed under the laws of Canada or Thailand. Next, the court must interpret the contract applying the definition of F.O.B. of the origin country. If the parties thought to include a choice-of-law provision choosing Thai law, the court may honor it; but if the court invalidates that clause (or if it does not exist), the court may determine that the contract is governed by the law of Canada. Despite the contrary intentions of the parties, the meaning of F.O.B. in their contract becomes the meaning used in Canada. In other words, the meaning of F.O.B. is contingent upon a court's application of a choice-of-law analysis. Because the meaning of the term might vary significantly between Thailand and Canada, the court's choice of law decision could very well be outcome determinative. Thus, without INCOTERMS, the uncertainty of trade term interpretation constitutes an undesirable form of trade risk. The simple solution: all international contracts, irrespective of origin, should be governed by INCOTERMS.⁸

INCOTERMS include a variety of trade terms from which the buyer and seller can select a term best suited to their needs. For example, if the buyer wishes to have the seller arrange and pay for all shipping matters including shipping insurance, the parties could agree to a C.I.F. contract, the most popular INCOTERMS shipping term. By including the term C.I.F. in the agreement instead of F.O.B., the contract divides the obligations and risk between seller and buyer much the same except that the seller must arrange and pay for a carrier and for insurance on the goods. The seller, however, arranges transportation and insurance in the buyer's name, and the risk for the goods still shifts to the buyer when the goods are put on board the carrier's vessel.⁹ The choice of C.I.F. instead of F.O.B. represents only one of the many options available to parties who use INCOTERMS. INCO-

⁸ For an illustrative guide to INCOTERMS use and the danger of trade term misuse, see generally INTERNATIONAL CHAMBER OF COMMERCE, INCOTERMS IN PRACTICE (Charles Debattista, ed., 1995).

⁹ INCOTERMS 1990, *supra* note 3, at 53.

TERMS provide endless flexibility because the parties are free to modify a term's meaning to further fit their special needs.

For most transactions, parties find INCOTERMS useful because the terms determine who is responsible at each step. In those instances where the goods are damaged or some other problem occurs, INCOTERMS enable the parties to quickly determine responsibility and risk for the activity in question. INCOTERMS cannot prevent lawsuits; but their use can substantially reduce the time and effort needed to adjudicate any dispute by clarifying the surrounding issues. The clarification and standardization of trade terms offered by INCOTERMS facilitates international business by ensuring a stable and fair basis for interpreting the legal meaning of contracts expressly incorporating INCOTERMS. Accordingly, many, if not most, international sales agreements include the INCOTERMS option.

However, when parties forget to include the "(INCOTERMS 1990)" clause, the contract falls outside of the protection of INCOTERMS and the parties are subject to the problems faced by the Canadian buyer and Thai seller in the example above. This proposal suggests that nations of the Asian Pacific adopt INCOTERMS as a common legal authority for international sales agreements. To return to the earlier example, suppose that Canada and Thailand had incorporated INCOTERMS 1990 into national law as the authority for interpreting the trade terms in the agreement signed by the Canadian seller and Thai buyer. In such a case, regardless of whether a court found the contract to have been executed under the laws of Thailand or of Canada, the meaning given to F.O.B. would be identical: the definition found in INCOTERMS 1990. This regularity of meaning can only be accomplished by the concerted actions of the Asian Pacific's national governments. If the nations agree among themselves to each implement legislation standardizing trade term interpretation, INCOTERMS will become the authority governing international sales contracts throughout the region, and all trading parties will enjoy its protection and benefit from enhanced commercial predictability.

3. PACIFIC RIM TRADE: A NEXUS BETWEEN APPF AND INCOTERMS

*Liberalizing and facilitating trade and investment in Asia-Pacific are vital in maintaining the region's dynamism as a global growth center that can positively impact the world economy.*¹⁰

One of APPF's goals is to promote better economic and political ties between its members by bringing parliamentarians of the different countries together to engage in friendly, non-exclusive dialogue.¹¹ The APPF also seeks to promote substantive trade reform as a means of promoting regional growth and stability.¹² APPF might endorse INCOTERMS as a positive step towards creating a stable, uniform trade environment in which traders of every nation could decrease the risk of uncertainty in contract interpretation. Standardizing INCOTERMS among Asian Pacific nations would bring tangible benefits to the region's trading partners such as:

- Uniformity, clarity, and predictability in trade term usage
- Reduction in litigation of trade term meaning
- Protection of small businesses and traders without international expertise
- Trade risk reduction through harmonization of trade rules

Standardized INCOTERMS reinforce each other. The uniformity, clarity, and predictability of INCOTERMS usage reduces trade risk by aiding parties in understanding each other.

¹⁰ ASIAN PACIFIC PARLIAMENTARIAN'S FORUM, NEW VISION OF THE ASIA-PACIFIC REGION IN THE 21ST CENTURY (working draft 1996) [hereinafter 1996 VISION DRAFT].

¹¹ See ASIAN PACIFIC PARLIAMENTARIAN'S FORUM, APPF PROCEDURES 1 (1994) ("A fundamental principle underpinning the Tokyo Declaration is the conviction that increased dialogue among parliamentarians of the Asia-Pacific region will add a new dimension to the framework of regional cooperation . . . contributing to the region's peace, stability and prosperity.").

¹² See generally 1996 VISION DRAFT, *supra* note 10.

INCOTERMS enable the sides to work within a fixed, universal framework of trade terms. Most parties can find a division of transportation-related rights and obligations satisfactory to both sides by merely looking through the standard terms available in INCOTERMS 1990. Thus, risk is reduced in two ways: first, parties are more likely to share a common understanding of the meaning of the trade term they use; and second, they can consult INCOTERMS 1990 to ensure the proper distribution of rights and responsibilities necessary to the transport of the sold goods.

The uniformity, clarity, and predictability of INCOTERMS reduce the likelihood of litigation. Disputes between parties over matters such as damaged goods will inevitably occur, but INCOTERMS usage suppresses the possibility of a collateral dispute over which party is liable for the goods at the time damage occurred. Determining when goods are damaged may require some good detective work, but absent any ambiguity over interpretation of a trade term's meaning, the dispute is likely to end with resolution of where the damage occurred. However, ambiguity as to the meaning of the contract's trade terms can quickly lead to a disagreement over which party was responsible for the goods at the time of damage. Such a dispute is much more likely to result in litigation. An INCOTERMS F.O.B. contract, however, specifies that responsibility for damage to the goods passes from seller to buyer at the time that the goods pass over the carrier's rail. Once it is clear where the goods were damaged, it is clear who is responsible for the loss. For example, for goods damaged on board the ship, the buyer is legally responsible for the loss. Thus, INCOTERMS leave little room for disagreement between buyer and seller over which party bears the loss. Claims brought by an injured party are likely to be settled quickly or summarily dismissed by the court.¹³

The advantages of INCOTERMS usage described in the preceding two paragraphs may be extended to traders who forget to include "(INCOTERMS 1990)" in their contracts if a nation adopts INCOTERMS as the default authority for defining the contract's F.O.B. provision or similar trade term. By making INCOTERMS a nation's legal default, trading parties who forget to expressly include INCOTERMS 1990 as the authority for their

¹³ Of course, a remedy may exist for the buyer against the carrier; but that issue, with the help of INCOTERMS, remains separate.

agreement automatically receive the benefits of INCOTERMS standardization. Incorporation of INCOTERMS 1990 into a nation's law would transform INCOTERMS from a private opt-in provision to a statutory opt-out provision. INCOTERMS could provide a safety net for small businesses and those unfamiliar with the complexities of international trade by operating as a statutory default.

The differences between opt-in and opt-out provisions are critical only for those parties who fail to specify legal authority for shipping terms. Today, INCOTERMS are opt-in provisions. INCOTERMS usage is prevalent throughout the world and businesses often use INCOTERMS. However, if parties forget to state which authority will govern interpretation of their trade terms, a court must make a determination, and the result may be unpredictable. A simple omission, the failure to include the phrase "(INCOTERMS 1990)," is so prevalent among businesses not familiar with INCOTERMS usage that in 1995 the ICC sent out two bulletins worldwide to warn against this oversight.¹⁴ Codification of INCOTERMS at the national level would transform this mistake from a substantive omission to a harmless error. At the same time, sophisticated traders could expressly agree to a non-INCOTERMS arrangement and ignore INCOTERMS altogether.

Finally, the standardization of trade term meaning across borders through region-wide adoption of INCOTERMS likely would benefit international trade significantly. All of the advantages of INCOTERMS (uniformity, clarity, predictability, litigation reduction, and automatic protection) are enhanced when available regardless of where the contract is executed. The more nations that adopt INCOTERMS, the more businesspersons should become comfortable with executing contracts in a foreign jurisdiction. If INCOTERMS become the prevalent domestic law among Pacific Rim trading nations, parties will enjoy the same protection whether a sales agreement is executed in the party's own country or in one of any number of other countries. The standardization of commercial terms in contracts would reduce one aspect of the risk peculiar to international trade, subsequently

¹⁴ See INTERNATIONAL CHAMBER OF COMMERCE, ICC 1995: THE ANNUAL REPORT OF THE INTERNATIONAL CHAMBER OF COMMERCE 8 (1995).

helping domestic operations to grow and to reach foreign markets.

Indeed, as domestic operations discover that foreign nations interpret INCOTERMS in the same manner as courts at home, the fear that foreign trade would drag the enterprise into protracted legal problems in a hostile environment would diminish, encouraging transboundary trade. Success in one foreign INCOTERMS nation would encourage trade with other INCOTERMS nations. While such protection might not be necessary for the sophisticated contract negotiator, small businesses without the means to obtain complete information on foreign rules and regulations might find the uniform use of INCOTERMS quite reassuring.

Thus, in light of the benefits of INCOTERMS usage by international traders, APPF should encourage its members to codify INCOTERMS as a small step towards harmonization of Pacific Rim trade rules. Section 4 considers what role the APPF might play in accomplishing this small task.

4. APPF ENDORSEMENT OF INCOTERMS

The endorsement of INCOTERMS by the APPF likely would benefit not only the development of a common Asian Pacific trade policy, but also provide an opportunity for the APPF to expand its regional role. The institutional reasons for APPF to implement this proposal are twofold: (1) APPF's institutional growth curve demands that it delve into more substantive policy work; and (2) APPF's stated goal of establishing itself as a contributor to Asian Pacific peace and prosperity dovetails with the objectives of this Essay. Even if the proposal at hand fails to win approval, the institutional experience might provide impetus for APPF to consider similar proposals in the future.

APPF consideration of INCOTERMS might take place in two tiers. At the first step, APPF members would evaluate the proposal at the plenary meeting. After discussing the proposal's merits, the delegates would decide whether to give or withhold APPF's endorsement. If the proposal were adopted, APPF would issue a resolution giving INCOTERMS its endorsement.

Before passing the resolution, the Chairman would ask for a delegate to voluntarily head up a work group in charge of issuing an official APPF report to APEC. The report would outline APPF's endorsement of INCOTERMS and recommend to APEC a treaty provision implementing INCOTERMS 1990 as the

statutory trade term authority for international sales agreements. The provision would be included in the next APEC treaty, and it would bind signatory nations to adopt INCOTERMS. After agreeing upon a delegate to head the APPF INCOTERMS Working Group, the members of the plenary meeting would pass a resolution endorsing INCOTERMS and appointing the volunteer delegate as head of the working group. The resolution would allow the working group one year from the date of resolution to draft a report to present to APEC. The report would describe INCOTERMS and the reason for APPF's endorsement.

While no one can predict what form an APEC treaty might take, this Essay provides an example of a codification of INCOTERMS. The first Appendix states model legislation designed to establish INCOTERMS as statutory authority.

APPENDIX A. MODEL INCOTERMS ACT¹⁵

1. Short Name for This Act. The Act shall be entitled, "The Model INCOTERMS Act".
2. Purpose of this Act. The purpose of this Act shall be to provide standard definitions of commercial trade terms used in contracts for the international sale of goods.
3. To whom it applies. This Act governs all contracts executed in this country for a sale of goods in which it is either:
 - (1) expressly agreed that:
 - (a) the goods sold shall be shipped from this country to a foreign country, or
 - (b) the goods sold shall be shipped from a

¹⁵ The legal requirements for instituting INCOTERMS as the official law of the nation would vary from country to country. The following is not tailored towards the statutory framework of any particular nation. The goal here is to crystallize the purpose of the APPF resolution in a legislative model demonstrating how INCOTERMS could be incorporated into national law.

The Model INCOTERMS Act would be limited in scope to contracts for the sale of goods to be transported from the home country to a foreign country or vice-versa. This Model Act does not change the law governing contracts for the sale of goods not transported outside of the home country's borders.

- foreign country into this country; or
- (2) where the court finds that:
- (a) the parties intended that the goods sold be shipped between this country and a foreign country such as in (l)(a) or (l)(b) above; and
 - (b) that the parties intended that the contract govern that aspect of the transaction.

4. Use of INCOTERMS. The use of an INCOTERMS trade term in a contract falling within the scope of this act shall be construed according to the meaning for the term defined herein.

[INCOTERMS 1990 terms incorporated herein by reference.]

5. Right to Opt-Out. By expressly stating so in the contract, the parties may choose another authority to govern the construction of any term defined in Section 4; and that authority shall be recognized as the contract's private law. However, where the parties fail to specify a substitute authority in the written contract, the contract's term appearing in Section 4 shall be construed according to the definition found in Section 4.

The Model INCOTERMS Act sets out the substantive legal goals of this proposal. Sections 1 names the Act, and Section 2 states its purpose. Section 3 limits the Act's scope to international sales agreements. Section 4 makes INCOTERMS the default authority for interpreting a contract's trade terms. Section 5 allows contracting parties to opt out of INCOTERMS and select another authority to govern interpretation of the contract. Clearly, the governmental structures and legal traditions of different nations would require modification of the Model INCOTERMS Act to fit within the existing legal framework particular to each. Nonetheless, the Model Act contains the necessary provisions. It should provide a starting point for dialogue among APPF members as to the ideal INCOTERMS Act and help the APPF Working Group recommend a treaty provi-

sion to APEC. Lastly, the Model Act may serve as a rough draft for actual laws to be introduced in the legislatures of APPF member states down the road.

APPENDIX B. MODEL RESOLUTION FOR CONSIDERATION BY APPF

As a multilateral institution possessing contacts with parliamentarians throughout the region, APPF is uniquely situated to disseminate information on the benefits and advantages of INCOTERMS to people in the position to implement this proposal. Therefore, in keeping with APPF's institutional mission, it should pass a resolution endorsing INCOTERMS as the region's legal authority for interpreting international trade terms and should follow up on the resolution with a report to APEC recommending a treaty provision mandating INCOTERMS standardization throughout the Asian Pacific. This proposal ends with a model resolution for consideration by APPF in formulating its own INCOTERMS resolution:

WHEREAS, it is found that INCOTERMS provides a fair, transparent, and predictable authority for governing the interpretation of trade terms in a contract for the international sale of goods.

WHEREAS, it is found that INCOTERMS reduces risk of litigation for traders of all APPF nations who engage in the international sale of goods.

WHEREAS, it is found that INCOTERMS protects the small businessperson and the contract party lacking trade expertise.

WHEREAS, it is found that the widespread adoption of INCOTERMS by APPF nations enhances the protection of INCOTERMS by harmonizing interpretation of contracts for the international sale of goods.

NOW, THEREFORE, be it resolved by the members of APPF that we endorse INCOTERMS and commend INCOTERMS to our home governments as worthy of

legislative adoption as the default authority for the interpretation of trade terms used in agreements for the international sales of goods.

AND, FURTHERMORE, be it resolved that we create an INCOTERMS Working Group to draft an official APPF Report on INCOTERMS to present to our sister organization, APEC.

AND, FURTHERMORE, be it resolved that we appoint the Honorable _____, delegate from _____ as Head of the INCOTERMS Working Group which Working Group shall submit its finished Report to the Chairman no later than one year from today.